

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 96-0635
CORPORATE INCOME TAX
FOR TAX PERIODS: 1992-1994**

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Issue

1. Adjusted Gross Income Tax: Business Income

Authority: IC 6-3-1-20, 45 IAC 3.1-1-30 .The May Department Store Company v. Indiana Department of State Revenue, 749 N.E.2d 651 (Ind. Tax 2001).

The taxpayer protests the classification of certain income as business income.

2. Adjusted Gross Income Tax: Michigan Single Business Tax Add Back

Authority: IC 6-3-1-3.5(b)(3), First Chicago NBD Corp., f/k/a NBD Bancorp, Inc., et al., v. Dept. of State Revenue, 708 NE2d 631, (Ind. Tax Court, 1999).

The taxpayer protests the add back of the Michigan Single Business Tax

3. Adjusted Gross Income Tax: Foreign Source Dividend Deduction

Authority: IC 6-3-2-12.

The taxpayer protests the calculation of the Foreign Source Dividend Deduction

Statement of Facts

The taxpayer is primarily engaged in developing, manufacturing and marketing consumer, professional, health and other imaging products and services. After an audit, the Indiana Department of Revenue (department) assessed additional corporate income tax. The taxpayer protested the assessment and a hearing was held. Further facts will be provided as necessary.

1. Adjusted Gross Income Tax: Business Income

Discussion

The taxpayer protests the classification of two different sources of income as business income. The first protested source is the 1994 sale of the division that supplied diagnostic products for use in clinical chemistry analysis and immunodiagnostics. The taxpayer reported this income as non-business income not subject to Indiana adjusted gross income tax. The department reclassified this income as business income. As business income, the department apportioned part of it to Indiana and subjected that portion to adjusted gross income tax.

In The May Department Store Company v. Indiana Department of State Revenue, 749 N.E.2d 651 (Ind. Tax 2001), the Indiana Tax Court determined that IC 6-3-1-20 provides for both a transactional test and a functional test in determining whether income is business or non-business in nature. Id. at 662-3.

The court looks to 45 IAC 3.1-1-29 and 30 for guidance in determining whether income is business or non-business income under the transactional test. These regulations state “. . . the critical element in determining whether income is ‘business income’ or ‘non-business income’ is the identification of the transactions and activity which are the elements of a particular trade or business.” Id. at 664. 45 IAC 3.1-1-30 lists several factors in making this determination. These include the nature of the taxpayer’s trade or business; substantiality of the income derived from activities and relationship of income derived from activities to overall activities; frequency, number or continuity of the activities and transactions; length of time income producing property was owned; and taxpayer’s purpose in acquiring and holding the property producing income. In May, the Court found that the transactional test was not met when a retailer sold a retailing division to a competitor because the taxpayer was not in the business of selling entire divisions. Id. at 664.

The nature of this taxpayer’s business included the development, production and sale of imaging products and services. Almost all of the taxpayer’s income derived from transactions associated with these activities. The division that the taxpayer sold was accounted for and run as a separate business unit for the ten-year period prior to its sale. The sale of the medical imaging division was an unusual and out of the ordinary transaction for the taxpayer. The sale of this division did not meet the transactional test for classification as business income.

The functional test focuses on the property being disposed of by the taxpayer. Id. at 664. Specifically the functional test requires examining the relationship of the property at issue with the business operations of the taxpayer. Id. at 664. In order to satisfy the functional test the property generating income must have been acquired, managed and disposed of by the taxpayer in a process integral to taxpayer’s regular trade or business operations. Id. at 664. The Court in May defined “integral” as part or constituent component necessary or essential to complete the whole. Id. at 664-5. The Court held that the May’s sale of one of its retailing division was not “necessary or essential” to May’s regular trade or business because the sale was executed pursuant to a court order that benefited a competitor and not May. In essence, the Court determined that because May was forced to sell the division in order to reduce its competitive advantage, the sale could not be integral to May’s business operations. Therefore, the proceeds from the sale were not business income under the functional test.

In the taxpayer's situation, the property being disposed of was the medical imaging division. The proceeds from this sale were used to establish a permanent irrevocable trust fund to extinguish long term debt. Because the taxpayer made these provisions to satisfy long term debts, it was able to focus more funds to the development and management of its consumer imaging products and services. The proceeds from the sales allowed the taxpayer to invest more into its primary function and complete the whole of its consumer imaging business. Thus they were necessary and essential for the functioning of the taxpayer's primary business endeavors. This distinguishes the taxpayer's situation from the May case where May sold its business operations pursuant to a court order to reduce its competitive advantage. Since the sale meets the functional test set out in the May case, the department properly classified the sale proceeds as business income subject to the Indiana adjusted gross income tax.

The department also reclassified the taxpayer's income from the sales of certain positions of stock as business income because the positions were held to further the taxpayer's current or future business operations. The sales of these positions of stock do not meet the transactional test because they are an out of the ordinary transaction of the taxpayer. They do not meet the functional test either because they were clearly held for an investment purpose. This is not "necessary or essential" to the taxpayer's regular business of developing, manufacturing and marketing consumer imaging products and services. Therefore the taxpayer properly reported the proceeds from the sale of positions of stock as non-business income not subject to the Indiana adjusted gross income tax.

Finding

The taxpayer's protest is denied in part and sustained in part.

2. Adjusted Gross Income Tax: Michigan Single Business Tax Add Back

Discussion

The taxpayer protested the department's adjustment of its adjusted gross income tax by adding back the Michigan single business tax pursuant to IC 6-3-1-3.5(b)(3). The taxpayer contends that the Michigan single business tax is not based on or measured by income and therefore does not need to be added back to the adjusted gross income. The Indiana Tax Court considered the issue of the Michigan single business tax in the case First Chicago NBD Corp., f/k/a NBD Bancorp, Inc., et al., v. Dept. of State Revenue, 708 NE2d 631, (Ind. Tax Court, 1999). In that case, the Tax Court determined that the Michigan single business tax was a value added tax rather than a tax based on or measured by income. Therefore, payments for the Michigan single business tax that were deducted to determine a corporation's federal adjusted gross income do not need to be added back to determine the corporation's taxable Indiana income.

Finding

The taxpayer's protest is sustained.

3. Adjusted Gross Income Tax: Foreign Source Dividend Deduction

Discussion

In calculating its Indiana tax liabilities, the taxpayer, pursuant to IC 6-3-2-12, deducted foreign source dividend income from its Indiana adjusted gross income. The department, however, disagreed with taxpayer's calculus. Re-calculation by the department resulted in an increase in taxpayer's Indiana adjusted gross income and tax. Proposed assessments of Indiana adjusted gross income tax followed.

The taxpayer, in response, directs the department's attention to the language of IC 6-3-2-12(b), which states:

A corporation that includes any foreign source dividend in its adjusted gross income for a taxable year is entitled to a deduction from that adjusted gross income. The amount of the deduction equals the product of:

the amount of the foreign source dividend included in the corporation's adjusted gross income for the taxable year; multiplied by the percentage prescribed in subsection (c), (d), or (e), as the case may be.

The aforementioned subsections (c), (d), and (e) allow corporate taxpayers to receive a one hundred percent (100%) deduction for foreign source dividends received from corporations in which a taxpayer has an eighty percent (80%) or larger ownership interest; an eighty-five percent (85%) deduction for dividends received from corporations in which a taxpayer has a fifty to seventy-nine percent (50%-79%) percent ownership interest; and a fifty percent (50%) deduction for dividends received from corporations in which a taxpayer has less than a fifty percent (50%) ownership interest. IC 6-3-2-12(c)-(e).

This statutory language is clear. IC 6-3-2-12 authorizes pro rata deductions (based on the percentage ownership of the payor by the payee) of certain foreign source dividend income. In this instance, taxpayer has followed the statutory prescriptions in calculating its foreign source dividend deductions.

Finding

The taxpayer's protest is sustained.